No. 11881

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

MARLBOROUGH CORPORATION,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S OPENING BRIEF.

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Jurisdiction.

At all times material hereto appellant has been a corporation, organized and existing under the laws of the State of California. Its principal place of business and office has been located at 735 Roosevelt Building, Los Angeles, California, and within the Sixth Internal Revenue Collection District of California [R. 222].

This is a proceeding to recover surtaxes erroneously assessed and collected by Nat Rogan, Collector of Internal Revenue for the Sixth District of California, under the provisions of Section 102 of the Revenue Act of 1938 and of the Internal Revenue Code, respectively. As said Nat Rogan was no longer in office at the time this action was commenced [R. 222] this action was brought against the United States pursuant to the provisions of Section 41 (20), Title 28, United States Code. The pleadings necessary to show jurisdiction in the District Court to hear and decide this case consist of the complaint [R. 2-12]

and the answer [R. 13-15]. The action was brought in the District Court of the United States for the Southern District of California, Central Division, pursuant to the provisions of Section 762, Title 28, United States Code, requiring the suit to be brought in the district in which the plaintiff (appellant here) resides.

Judgment for the appellee was entered August 30, 1947, and the notice of appeal was filed November 25, 1947, pursuant to the provisions of Section 230, Title 28, United States Code. Jurisdiction to review the decision of the District Court below lies in this Court under the provisions of Section 226, Title 28, United States Code.

Statement of the Case.

Appellant is a California corporation with principal office at 735 Roosevelt Building, Los Angeles, California [R. 222]. Since about 1927 its stock has been owned in equal shares by Eugene and Georgia Overton, husband and wife [R. 83]. Mrs. Overton acquired the stock from her mother, Mrs. Mary S. Caswell, at the latter's death in 1925. The stock was divided equally in a property agreement between the spouses in 1927 [R. 83-84].

During the taxable years in question (the years ended August 31, 1939, and August 31, 1940), and for some years prior thereto, the business of the appellant consisted of:

1. Owning, controlling, and leasing to one Ada Blake, the premises, buildings, equipment, furnishings, name and goodwill of a going business known as Marlborough School [R. 47, 92-93]. The physical properties consisted of land, two large school buildings, furnishings and equipment located at Third and Rossmore Streets in Los Angeles [R. 36, 237]. During the respective years in ques-

tion some 247 and 228 day students attended the school [R. 238]. Under the terms of the lease to Miss Blake, appellant reserved and on occasion exercised certain powers of control over the financial and academic activities of the lessee [R. 48, 84-94, 248]. Appellant, as lessor, also participated in the earnings from the school on a profit-sharing basis [R. 231, 246].

2. Owning and receiving the income from stocks, bonds, and notes held for the purpose of building up a reserve fund for the reasons hereafter noted [R. 99].

From the year ended August 31, 1933, to the close of the years in question appellant had net earnings, paid dividends, and had surplus balances per books and after income taxes as follows:

ANALYSIS OF SURPLUS—(per books)

Date	*Item*	*Debit*	*Credit*	*Balance*
8-31-1933	Balance			$153,927.78
8-31-1934	Profit & Loss		$ 888.36	162,816.14
8-31-1935	Profit & Loss		1,029.77	163,845.91
8-31-1936	Profit & Loss		876.75	
	Dividends	$ 1,250.00		163,472.66
8-31-1937	Profit & Loss		6,905.37	
	Dividends	2,500.00		167,878.03
8-31-1938	Profit & Loss		19,350.96	
	Dividends	5,500.00		181,728.99
8-31-1939	Profit & Loss		30,115.61	
	Dividends	17,500.00		194,344.60
8-31-1940	Profit & Loss		21,788.32	
	Dividends	2,500.00		213,632.92

[R. 233]

During the taxable years in question appellant had taxable net income (before taxes) and before the Section 102 taxes here in issue, and paid taxes thereon as follows:

Year Ended	*Taxable Net Income*	*Ordinary Income Taxes*	*Sec. 102 Surtaxes*
August 31, 1939	$37,337.55	$6,279.36	$3,389.55
August 31, 1940	21,870.32	3,460.37[1]	5,112.03

[R. 222, 223]

The Section 102 surtaxes are the only taxes in issue in this case [R. 223].

Appellant was incorporated in 1910 by Mrs. Overton's mother, Mrs. Mary S. Caswell. It was first located in Pasadena and was moved shortly after to Twenty-Third Street, a little east of Hoover Street in Los Angeles [R. 36].

By 1916 the population of the city had so shifted westerly that Mrs. Caswell decided again to move the school to its present location at Third and Rossmore in Los Angeles. Mrs. Caswell had accumulated no money to finance the move and got into serious financial difficulties [R. 37].

In acquiring a new site and buildings, the corporation, over and above what it obtained for the old site, borrowed $14,000 to buy land; $85,000 to erect the school buildings, lay out the grounds, moving expense, etc., and $1,680 for architect's fees [R. 234]. Had it not been for the willingness of G. Allen Hancock and Eugene Overton to personally guarantee the loans, and Overton's friendship

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[1]$3,460.37 is total of tax ($2,535.91) paid on return [R. 222] plus additional tax ($924.46) paid as deficiency and not in issue in this case [R. 223].

with Mr. Morgan Adams of the Mortgage Guarantee Company, the money could not have been obtained, and the school [corporation] would have failed [R. 44-46]. Apart from debts owing the Overton family, the corporation remained in debt from 1916 to 1934 [R. 37], and was making refinancing loans as late as 1928 [R. 235]. A total of $172,680 was borrowed over the years to finance the cost of the original land and buildings and subsequent improvements [R. 235]. These loans were paid off out of earnings which required the payment of interest, which, as a corollary, reduced the corporation's ability to repay [R. 47].

The history of this corporation up to 1935 was, therefore, one of a continuous struggle to pay off indebtedness incurred to finance its facilities.

Some years prior to those in question [R. 37-38] Mr. Overton, who handled the financial affairs of the business [R. 36], concluded that this business should accumulate a backlog of around $250,000 of liquid assets to provide adequate working capital; for contingencies; for replacement of expensive buildings and equipment, and for the payment of the remaining indebtedness of the corporation [R. 38, 56, 99]. In 1936 or 1937 and again in 1939 Mr. Overton undertook to verify his judgment as to the necessity for such a backlog by preparing two informal memoranda which summarized the needs of the business as he saw them [R. 38; Plaintiff's Exhibits 1 and 2, R. 257-258].

This exercise of his business judgment will be discussed in detail in the Argument. It will suffice to say here that the trial court must have found the corporation's accumulated reserve reasonable since, although it was a

hard-fought issue in the case, the court did not find it unreasonable. [See Findings and Conclusions, R. 23-29.]

In the year ended August 31, 1939, the corporation had the best earnings in many years [R. 231] and in that same year the Overton's son wanted to buy a ranch.

Before Mrs. Caswell died she desired to leave her grandson, Mark Overton, a considerable sum of money in her will. The Overtons, not wishing the boy to consider himself as having such a sum as an inheritance, asked Mrs. Caswell to put her wishes in the form of a letter. They agreed to pay him that sum when the proper time came [R. 66]. This letter was prepared by Mrs. Caswell and is in the record as Plaintiff's Exhibit No. 5 [R. 261]. Around 1931 an abortive attempt to fulfill this moral obligation out of Mrs. Caswell's estate was made when the son was about to be married. $5,000 of the corporation's funds were given him in cash together with a note of the corporation for the balance. The corporation's auditors objected to this and in deference to their views the Overtons each took a credit of $10,000 on notes which they themselves held against the corporation for moneys actually advanced to it [R. 60]. Thus, the gift did not come from Mrs. Caswell's former estate but from the parents themselves.

When, in 1939, the son wanted a ranch, the Overtons caused an extra dividend to be declared sufficient to provide the means of fulfilling what they deemed to be a moral obligation to Mrs. Caswell. This means was chosen to avoid any second complaint from the taxpayer's auditors [R. 66]. This, of course, delayed the accumulation of the contemplated reserve, but the Overtons regarded the moral obligation as being of paramount importance.

The items making up the reserve fund will be discussed more particularly in the Argument but in general consisted of certain specific needs which Mr. Overton, as the financial officer, could foresee.

In the years in question the appellant was definitely considering but had not definitely decided to take over active conduct of the academic part of the school operation at the expiration of the existing lease to Miss Blake in 1942. This was actually what occurred [R. 41, 50, 76]. In anticipation thereof Mr. Overton, in both of his reserve-fund memoranda [R. 257, 258], made provision for the working capital which would be necessary if the lease should be terminated. The $50,000 allocated for this purpose was to cover the usual summer expenses and upkeep, about $25,000 [R. 82] and the balance was to cover extraordinary renovation and redecoration of the interior and furnishings of the school [R. 82, 103, 192]. Mrs. Overton, who was in charge of these matters [R. 101], made the estimates of need in the latter respects [R. 40].

Mrs. Overton had long been of the opinion that the boarding school (resident students) should be eliminated [R. 40, 102]. This *was* done at the expiration of the lease [R. 40, 210]. Mrs. Overton's estimate of the expense of elimination of the boarding school was $15,000 [R. 40].

Another need urged by Mrs. Overton was the modernization of the gymnasium, showers, and locker rooms, at an estimated cost of $35,000. Built in 1916, the gymnasium had never been sealed; the studding was exposed and the showers and locker rooms were very old, too small, and generally inadequate [R. 41, 103-104].

A further sum of $20,000 was provided to provide for fire losses not covered by insurance. Built in 1916,

the main (frame) building was a hazardous fire risk [R. 39]. This was also expected to partially cover the refund of tuition and payment of teachers' salaries if the school should be interrupted by a fire [R. 40].

$20,000 was provided to cover earthquake damage and interruption of school activities thereby [R. 40, 257, 258].

$35,500 was provided to pay the indebtedness to the Overtons [R. 257].

This had been originally incurred in 1925 to pay off the Mortgage Guarantee Company loan, made to finance the cost of the original main building [R. 235]. This item was overlooked in the 1939 memorandum [R. 44, 258].

The last item provided for was described as "obsolescence and depreciation," for which $67,000 was provided in the early memorandum and $75,000 in the later one [R. 257, 258]. The purpose of the provision was twofold; to provide for replacement of buildings if replaced at the then location [R. 43], and in the alternative to partially pay the cost of moving should such course become necessary [R. 42, 43, 186].

At August 31, 1940, accumulated depreciation on the main building alone was $74,737.82 [R. 237]. This, however, was on *original* cost, and both the witnesses for the appellant and appellee who testified as to the cost of replacing the main building put the amount at from $255,000 [R. 115] to $265,000 [R. 171, 263].

The earnings of the corporation were accumulated during the taxable years in issue for the purposes noted above [R. 36].

While they were aware of the tax effect of retaining such earnings in the corporation, as is any informed person, it did not influence the Overtons' decision in consider-

ing dividends to be distributed. No computations were ever made [R. 54].

No loans, except for one of about five days in 1932 in the amount of $1,000, have ever been made to stockholders [R. 54, 59].

On the contrary the stockholders have loaned, and up through the taxable years were still loaning, money to the corporation [R. 54].

No personal assets were ever transferred to the corporation which thereafter stood the cost of upkeep [R. 55].

No profit-yielding securities, bonds or other properties have ever been transferred to the corporation to escape personal surtaxes [R. 55].

The amount of the surtaxes actually avoided were relatively small [R. 239].

The difficulties of borrowing funds were unanimously attested to by Mrs. Caswell's experience [R. 44]; by the Overtons' own experience [R. 44]; by the experience of Morgan Adams, a witness having wide experience in making loans [R. 110, 112]; by the experience of Thompson Webb, a witness of twenty-four years' experience in building and operating one of the foremost boys' schools in the country [R. 119].

The soundness of setting aside a replacement fund to cover depreciation on long-lived school buildings was unequivocally maintained by Thompson Webb and on the authority of the American Council on Education [R. 120-125].

Notwithstanding these considerations, the Commissioner of Internal Revenue asserted that the tax under Section 102 was due from appellant for its fiscal years ended August 31, 1939, and 1940, respectively [R. 223].

As was its privilege, in order to avoid the accumulation of interest, appellant elected to pay the tax and claim a refund thereof. This was done [R. 223]. Upon rejection of those claims this suit was brought to recover the tax by court action.

The case was heard by the late Judge Harry A. Hollzer who passed away before rendering his decision. It was reheard by the Honorable Jacob Weinberger on December 16, 1946, in a brief hearing at which, in the words of appellee's counsel below, "nothing new" was developed [R. 35, 203]. It was taken under submission by Judge Weinberger by a pre-trial order dated October 2, 1946, upon the pleadings, record and briefs submitted to Judge Hollzer [R. 22].

The trial court's findings and conclusions disclose that the court's decision was based upon the following logic:

(1) The taxpayer was a mere holding company. This is *prima facie* evidence of a purpose to avoid surtaxes upon the shareholders.

(2) Taxpayer has not overcome this *prima facie* evidence and, therefore, has not proved that there was no purpose to avoid such surtaxes.

(3) Taxpayer was, therefore, availed of for the proscribed purpose. [Conclusions I, IV, II and III; R. 28-29.]

The trial court's findings and conclusions make it apparent that this case is not before this court on appeal to set aside the findings of the trial court. The problem is whether, upon the record, appellant adduced sufficient

evidence to carry its general burden of proving the absence of a purpose to avoid surtaxes upon its shareholders. In other words, the issue here is not whether the lower court erred in finding that such purpose existed, because the court was unable to do so except upon the basis of the presumptive effect of what it considered "mere" holding company status. Rather, the issue is whether the court, having been unwilling to find specifically that such purpose did exist, should have found from the evidence submitted by appellant that appellant's accumulations were motivated by purposes other than that purpose which invokes the penalty of Section 102 of the law.

Specification of Error to Be Urged.

(1) The trial court erred in concluding that appellant was a mere holding or investment company within the meaning of Section 102 of the Revenue Act of 1938 or of Section 102 of the Internal Revenue Code.[2]

(2) The trial court erred in finding and concluding that the presumptive effect of appellant's status as a holding or investment company was not overcome by the evidence introduced by appellant.

(3) The trial court erred in concluding that appellant had not proved that there was no purpose to avoid the imposition of surtax upon the income of its shareholders.

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[2]Under Section 1, of the Internal Revenue Code, the Code was applicable to taxable years beginning after December 31, 1938. Thus the Revenue Act of 1938 applied to taxpayer's year ended August 31, 1939.

Summary of the Argument.

(1) Appellant is not a mere holding or investment company. In the field of federal income taxation the leasing or renting of properties or of a going business has been regarded universally as operating a business as distinguished from holding or making investments.

Moreover, the appellant's activities went beyond simply leasing its properties and business. The lease reserved and the lessor exercised certain powers to control the conduct of the activities of the school. In such cases it has been held that the corporation is not a "mere" holding or investment company.

This being so, the record contains no *prima facie* or presumptive evidence of a purpose to avoid surtaxes upon its shareholders. In the absence of such presumption the sole question in issue is whether, upon the record, the appellant carried its general burden of proving that its accumulations of earnings were not motivated by the purpose proscribed by the law.

(2) In the event that the appellant is found to have been a mere holding or investment company within the meaning of the statute, that *fact* constitutes *prima facie* evidence of a purpose to avoid surtaxes in accumulating the taxpayer's earnings. This is, however, no more than a presumption. If any valid evidence to the contrary is introduced, the presumption falls and the issue then becomes whether upon the record the taxpayer has carried its burden of proving that its accumulations of earnings were not motivated by a purpose to avoid surtaxes upon the shareholders.

In the instant case there is ample evidence to rebut the presumptive effect of the fact of holding or investment

company status, should this court decide the first issue that way. By all of several tests often applied by the courts to determine the existence or absence of such purpose, the evidence, stipulated and otherwise, contradicts the presumption. Since this evidence must be reviewed in considering whether appellant carried its general burden of proof below, it will be summarized only under the third point of the Argument to avoid unnecessary repetition.

(3) In the instant case the trial court did not specifically hold that the evidence disclosed a purpose to avoid surtaxes. Indeed, the trial court could not so have held. No evidence other than that regarding the salvage value of appellant's properties was introduced by appellee, and no evidence of the proscribed purpose was elicited by appellee from the examination of any of the witnesses.

Nor did the trial court find that appellant's earnings were permitted to accumulate beyond the reasonable needs of its business. This fact, if supported by the record, would have been determinative of the purpose to avoid surtaxes unless taxpayer, by a clear preponderance of the evidence, had proved to the contrary. The fact that the trial court did not find that appellant's earnings were accumulated beyond the reasonable needs of its business amounts to a finding that such accumulations were reasonable since, by the statute, this fact was at all times a crucial issue in the case.

The precise holding of the trial court was that "plaintiff has not proved that there was no purpose to avoid the imposition of surtax upon the income of its shareholders."

The third issue on this appeal, precisely stated, is whether, at the trial below, appellant produced evidence sufficient to carry its general burden of proving the ab-

sence of that purpose to avoid surtaxes on its shareholders which is necessary to justify the collection of taxes under Section 102.

Appellant submits that the statute itself prescribes the *maximum* measure of the taxpayer's burden of proof when it provides that if its accumulation of earnings is unreasonable the taxpayer must prove the absence of such purpose by "the clear preponderance of the evidence." (Section 102(c), I. R. C., and 1938 Revenue Act.)

If, when the fact of unreasonable accumulation of earnings is present, the measure of proof necessary to enable the taxpayer to prevail is the clear preponderance of the evidence, certainly its burden of proof is not increased when the fact of unreasonable accumulation is absent.

Appellant argues that not only by the clear preponderance but by the overwhelming weight of the evidence it proved the absence of the purpose to avoid surtaxes which is the ultimate issue in the case.

Appellant so contends because by each of some dozen tests of conduct which the courts have generally applied to ascertain the purposes of management in Section 102 cases, the motives of the officers and directors of this taxpayer are shown to have been bottomed upon business considerations rather than surtax avoidance. So overwhelmingly in appellant's favor is the evidence which this record contains that even if the trial court had affirmatively found that the purpose to avoid surtaxes existed, this court would have been justified, under the rules and the cases, in setting aside such a finding as being clearly erroneous.

ARGUMENT.

I.

Appellant Was Not a Mere Holding or Investment Company Within the Meaning of Those Terms as Employed in Section 102 of the Revenue Laws.

The applicable statutory provision here involved is:

> "The fact that any corporation is a mere holding or investment company shall be *prima facie* evidence of a purpose to avoid surtax upon shareholders."[3]

Congress must be presumed to use words in their known and ordinary signification. The popular or received import of words furnishes the general rule for the interpretation of public laws.[4]

The ordinary signification of the word "mere" according to Webster[5] is "only this and nothing else; nothing more than; such; and no more; *as*, a *mere* form."

Had it been Congress' intention to treat all companies which hold property or make investments alike, it would have been a simple matter to have omitted the word "mere" from the statute. That Congress did not do so conclusively shows that it intended to cover a special class of taxpayers in this provision.

A holding company is one which holds property and collects the income therefrom. An investment company is one which invests and reinvests in property not only for

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[3]Section 102(b), Revenue Act of 1938, and of the Internal Revenue Code.

[4]*Old Colony Railroad Company v. Commissioner of Internal Revenue*, 284 U. S. 552, 52 S. Ct. 211, 76 L. Ed. 484;

[5]*Webster's Collegiate Dictionary*, Fifth Ed., p. 1948.

the investment yield but also to derive profits from the fluctuations in value of the property.[6]

A corporation which does something substantially more than merely holding or investing in property is not a "mere" holding company.[7]

In the *Olin Corporation* case the taxpayer held the securities of a number of corporations which together constituted an integrated arms, explosives and ammunition producing group. It financed the subsidiaries with loans and by purchases of their stocks. Other than this, however, its only activities consisted of conducting certain experiments in the purification of wood fibres.

The court held that while Olin Corporation was primarily a holding and investment company, it was unwilling to say that the taxpayer was a *mere* holding or investment company under the statute.

The issue whether certain activities constitute, for tax purposes, business operations as distinguished from mere holding or investment activities, has been before the courts many times in connection with the deduction of business expenses by individuals. The leading case is *Higgins v. Commissioner of Internal Revenue,*[8] in which it was conceded by the Commissioner and held by the

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[6]Regulations 103, Sec. 19.102-2.

[7]*Olin Corporation v. Commissioner of Internal Revenue,* 42 B. T. A. 1203, 1214.

[8]312 U. S. 212, 61 S. Ct. 480, 85 L. Ed. 783.

Board of Tax Appeals that the real estate activities of the taxpayer in renting buildings constituted doing business as distinguished from "mere personal investment activities." The Circuit Court of Appeals affirmed, and in affirming all lower courts the Supreme Court recognized the distinction by stating that expenses attributable to each type of business could be apportioned between them.[9]

In the instant case there was not only the renting of land and buildings but of all the facilities, name and goodwill of the going business known as "Marlborough School" [R. 92, 241]. Realizing the detrimental effect of mismanagement of the business, the appellant-lessor retained in the lease the power to control financial and academic policies of the lessee [R. 248]. These powers were exercised sparingly, but they were exercised from time to time during the term of the lease [R. 49].

Since it appears that the renting of property is universally regarded as operating a business as distinguished from holding investments, it follows that the trial court erred in finding appellant to be a mere holding company.

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[9]Opinion at page 218.

II.

The Evidence Introduced by Appellant Was Sufficient to Overcome Any Prima Facie Effect Which the Fact of Holding Company Status May Have Created.

Should this court sustain the trial court's finding that appellant was a mere holding company under the law, that fact is only *prima facie* evidence of a purpose to avoid surtaxes.

According to the authorities *"prima facie"* evidence may have either of two characteristics:

(a) *Prima facie* evidence may be that which gives rise to a compelled inference if no evidence to the contrary is introduced. In this sense it gives rise to a presumption which disappears when contrary evidence is introduced. In such cases the issue is decided as if the presumption never existed.

> *Hemphill Schools, Inc. v. Commissioner of Internal Revenue,* 137 F. (2d) 961;
>
> *Webre Steib Company v. Commissioner of Internal Revenue,* 324 U. S. 164, 170, 65 S. Ct. 578, 89 L. Ed. 819.

(b) *Prima facie* evidence may be that which gives rise to a permissive inference. In this sense it is used to denote evidence sufficient to sustain the proponent's burden of proof in the case. It is often referred to as a *"prima facie* case" consisting of evidence sufficient to go to the jury. Dean Wigmore puts the test of the *sufficiency* of such evidence thus: "Are there facts in evidence which if unanswered would justify men of ordinary reason and fairness in affirming the question which the plaintiff is bound to maintain." *Wigmore on Evidence*

(1940), Vol. IX, §2494; *Webre Steib* case, *supra,* opinion p. 169, citing Wigmore's distinction.

The precise question on this appeal is whether the fact of holding company status constitutes *prima facie* evidence of the first or second type. Appellant contends that under Section 102(b) of the applicable law (as under corresponding sections of prior law) holding company status gives rise to a presumption from which the inference of purpose to avoid surtaxes is compelled if, and only if, no evidence to the contrary is introduced.

In the leading case,[10] construing virtually the same language in Section 220 of the 1921 Revenue Act as is involved here, Justice Learned Hand said:

> "A statute which stands on the footing of the participant's state of mind may need the support of presumption, indeed be practically unenforceable without it, but the test remains the state of mind itself, and the presumption does no more than make the taxpayer show his hand."

This court took a similar view of the nature of "*prima facie* evidence" in Section 102 cases in its decision in *Hemphill Schools, Inc. v. Commissioner of Internal Revenue, supra.*

Finally, under this point in argument the question remains whether any evidence, contrary to the presumption, was introduced by appellant. Since it will be necessary to review the evidence necessary to support appellant's general burden of proof under the third point in argument, reference is made to that portion of this brief

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[10]*United Business Corporation v. Commisioner of Internal Revenue,* 62 F. (2d) 754, 755.

where there appears a summary of evidence amply sufficient to overcome the presumptive effect of holding company status.

There having been evidence introduced by appellant contrary to the presumption raised by holding company status, that presumption forthwith disappeared, and the case must be decided as if it never existed.

Webre Steib Company case, *supra.*

III.

The Trial Court's Conclusion That Appellant Has Not Proved That There Was No Purpose to Avoid the Imposition of Surtax Upon the Income of Its Shareholders Was Clearly Erroneous.

As noted before, the trial court's decision was bottomed upon the conclusion that appellant did not, by its evidence, overcome the presumptive existence of the purpose to avoid surtaxes which arose out of holding company status.

Even if the trial court erred in that respect, appellant, as proponent in the case, had the general burden of proof imposed upon any claimant against the Government. That is to say, the *facta probanda* of appellant's case were:

(a) That it paid Section 102 surtaxes to the appellee for the years in question.

(b) That the fact which is the taxable incident (the purpose to avoid surtaxes upon its shareholders by accumulating earnings during those years) did not exist.

(c) That timely claims for refund of such taxes were filed by appellant and rejected by appellee.

(d) That the taxes have not been refunded, and appellant refuses to refund them.

All the necessary facts contained in paragraphs (a), (c) and (d) were stipulated by the parties, or admitted in appellee's Answer [R. 13-14, 223, 224]. These stipulations left, as the only remaining essential fact to be proved in the case, that during the taxable years appellant's accumulations of earnings were not motivated by a purpose to avoid surtaxes upon its shareholders.

Thus whether or not the presumption dealt with in Points I and II of the argument existed, appellant's problem of proof was the same; for if appellant carried its general burden of proof, that in itself would be sufficient to destroy the effect of the presumption.

The question under this point of the argument is thus narrowed to the question whether appellant offered sufficient evidence of the absence of such purpose that the appellate court can say that the trial court's finding was clearly erroneous.

This posture of the case on appeal presents two underlying questions, the answers to which will determine whether the trial court's findings were clearly erroneous:

(1) Was the evidence adduced by appellant to prove the absence of the purpose in issue such, in the absence of any substantial evidence to the contrary, that the trier of the facts, acting as would reasonable men, must be persuaded to find for appellant on that issue?

> *Wigmore on Evidence* (1940), Vol. IX, §2487, p. 280.

(2) Was there, in this record, any substantial evidence contrary to that in favor of appellant from which the trier of the facts could reasonably find that the purpose to avoid surtaxes existed?

If the answer to the first question is "yes," and to the second "no," then the trial court's ultimate conclusion was clearly erroneous and should be reversed.

1. Sufficiency of Appellant's Evidence to Sustain Its Burden of Proof.

Dean Wigmore, in describing the burden of proof which the proponent in a case must sustain, says:

> "Suppose, however, that the proponent has been able to go further and to adduce evidence which if believed would make it beyond reason to repudiate the proponent's claim,—evidence such that a jury, acting as reasonable men, must be persuaded and must render a verdict on that issue for the proponent. Here the proponent has now put himself in the same position that was occupied by the opponent at the opening of the trial, *i.e.*, unless the opponent now offers evidence against the claim and thus changes the situation, the jury should not be allowed to render a verdict against reason."[11]

Without going into great detail, appellant adduced the following evidence tending to prove the absence of the purpose in issue:

1. Taxpayer was not a holding or investment company. (*Cf.* Argument I.)

2. While aware of the tax effect of retaining earnings, Overton did not let that influence his conclusions [R. 54].

3. Except for a loan of five days in 1932, appellant did *not* loan its funds to its stockholders [R. 59].

Wilkerson Daily Corp. v. C. I. R., 125 F. (2d) 998.

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[11] *Wigmore on Evidence* (1940), Vol. IX, §2487, p. 280.

4. Loans *were* made by the stockholders to the corporation to finance the acquisition of assets used in the business [R. 54].

Seaboard Security Co. v. C. I. R., 38 B. T. A. 560; *Mellbank Corp. v. C. I. R.*, 38 B. T. A. 1108, 1118.

5. There was no transfer of personal assets such as residences, farms, automobiles, yachts, etc., to the corporation which thereby bore the expense of their upkeep [R. 55].

Regulations 103, Sec. 102-2.

6. The stockholders did not transfer any personal securities or other properties to the corporation so as to escape surtaxes upon the income therefrom [R. 55].

Mellbank case, *supra*, p. 1117.

7. Appellant did pay large dividends to its stockholders in the year ended August 31, 1939.[12] While the amount of these dividends was influenced by a desire to secure funds in order to purchase a ranch for the stockholders' son [R. 66], the distribution shows an indifference to the effect of dividends upon the stockholders' surtaxes since the money could have been obtained by causing the appellant to repay its loans to those stockholders.

8. Appellant's earnings and profits were not accumulated beyond the reasonable needs of its business. Despite this was a hard fought issue [R. 21, 124, 127, 129], the trial court was unwilling to find for appellee on this issue.

9. Appellant accumulated funds for the purpose of creating a reserve of liquid assets to provide for ascertainable and foreseeable needs of the business [R. 36, 99].

Lion Clothing Co. case, *supra*, p. 1189.

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[12]*Lion Clothing Co. v. C. I. R.*, 8 T. C. 1181, 1191.

10. From sad experience appellant's officers knew the difficulties and hazards of borrowing to finance a school business. Its officers desired to accumulate funds to avoid this necessity [R. 36, 44-47].

Lion Clothing Co. case, *supra,* p. 1190.

11. During each of the taxable years in question, the bulk of appellant's original capital and accumulated earnings was already invested in tangible assets actually in use in its business. These assets were:

Land at cost	$ 36,368.07	[R. 229]
Buildings, equipment, furniture and furnishings at cost[13]	240,857.92	[R. 229]
Total physical assets in use in business at cost	$277,225.99	

The acquisition of these facilities was originally financed out of original capital, early loans, and accumulated earnings in the following manner:

Original capital stock	$ 50,000.00	[R. 239]
Net loans (excluding refinancing)	172,680.00	[R. 235]
	$222,680.00	
Accumulated earnings	54,545.99	
	$277,225.99	

[13]Plant and machinery were understated by 20 cents in Stip. No. 2 [R. 237]. The total of depreciable assets at cost should be $240,857.92 as it is in the balance sheet [R. 229].

As further earnings were accumulated over the years and the loans (except for $35,500.00 owed the Overtons) were repaid therefrom, the surplus gradually replaced the debts in the appellant's balance sheet. [*Cf.* R. 230.] The source of the funds used to acquire the tangible properties used in the business then became:

1. Original capital	$ 50,000.00
2. Earnings used to pay off loans, ($172,680 total, less loans from Overtons of $35,500.00)	137,180.00
3. Loans from Overtons	35,500.00
4. Other accumulated earnings	54,545.99
Total tangible assets used in business	$277,225.99

The total accumulated earnings so used were Item 2, $137,180.00, plus Item 4, $54,545.99, or $191,725.99.

Thus of total accumulated earnings as at August 31, 1940 ($213,632.92) [R. 239], $191,725.99 were *already* at work in appellant's business. *The balance of such accumulated earnings ($21,906.93) together with depreciation recoveries, as shown by the depreciation reserves of $180,582.31* [R. 229] *were, during the taxable years, held in the form of cash and liquid securities to provide for current liabilities and the needs set forth in Overton's financial policy memos* [R. 99, 230, 257, 258]. A summary of these items is as follows:

SCHEDULE OF ASSETS HELD TO PROVIDE FOR CURRENT NEEDS AND CONTINGENCIES RELFECTED IN POLICY MEMOS [R. 229-230].

Assets		*Source*	
Investments	$157,093.29	Earnings not invested in fixed assets	$ 21,906.93
Note	950.78		
Accrued interest	805.50	Depreciation recoveries	180,582.31
Cash	39,679.84		
Accounts receivable	8,463.08		
Deferred expense	170.91		
	$207,163.40		
Less amounts due on current payables:			
Accounts payable	414.16		
Property taxes payable	100.00		
Income taxes payable	3,700.00		
Capital stock tax payable	460.00		
Total free assets held	$202,489.24	Source of assets held in reserve	$202,489.24

It is not difficult to see why the trial court was unwilling to find appellant's accumulations unreasonable.

As Overton testified, the amounts which he had set aside to cover depreciation sustained [R. 41-42] and the additional cost of replacement [R. 44] were most inadequate. These items were long-range in character but had to be considered if the difficulties of borrowing large sums were to be avoided. School buildings, equipment and furnishings are long-lived assets. When they do re-

quire replacement it takes large sums of money to finance their cost. The trial court saw the sound judgment upon which this provision was bottomed, particularly in the light of the fact that the main building alone, which originally cost $95,178.17 [R. 229], could be replaced in 1939 and 1940 only by an expenditure in excess of $255,188.00 [R. 116].

Besides this most important of all items, the Overtons accumulated liquid assets from earnings and depreciation recoveries for the following purposes:

(a) $50,000.00 for working capital needed upon resumption of active conduct of academic activities [R. 41, 180]. This was done [R. 72].

(b) $35,000.00 for modernizing the gymnasium, showers and locker rooms which were unsealed and out of date [R. 41, 57].

(c) $15,000.00 for remodeling to eliminate the boarding department. This was done [R. 40, 178].

(d) $20,000.00 to cover fire losses not insured and to cover the refund of tuition, payment of help, and related expenses in case the school had a serious fire [R. 38, 40, 178].

(e) $20,000.00 to cover losses and expenses in case of earthquake, as no earthquake insurance was carried [R. 187].

(f) $35,500.00 to repay loans made to the corporation by the Overtons [R. 187].

12. Mr. Thompson Webb, a disinterested witness and himself an owner and operator of a boys' school for many years, testified that not only was the policy of funding depreciation reserves a matter of good judgment but also that the retention of earnings by the appellant

under the circumstances in this case was "imperative" whether or not the possibility of moving the school was imminent [R. 127].

13. Mr. Morgan Adams, long experienced in the loaning business and having specific experience as the trustee of a private school, testified without contradiction as to the preferability of financing school facilities out of earnings rather than borrowing [R. 112].

We regret having reviewed all this evidence at length, but it is necessary to do so to demonstrate to this court that appellant's proof did not consist of a few statements of its purposes for accumulating funds unsupported by independent and logical circumstances. This evidence is clear, full, uncontradicted, not extraordinary nor incredible. The record shows that there was no dispute as to the evidence, but rather as to the ultimate conclusion to be drawn therefrom. It is in this respect that appellant contends that the trial court erred in finding that evidence, as clear and of such preponderance as was here adduced, was insufficient to carry appellant's burden of proof.

It should be remembered that this case was submitted largely upon the basis of stipulations, and the record made before Judge Hollzer. Respecting the testimony before Judge Weinberger, the most that can be said for it was, in the words of appellee's counsel, that "nothing new developed" [R. 203].

In such circumstances this court is in just as good a position to draw the ultimate conclusions respecting purpose as was the trial court.

Compare:

Crutcher v. Joyce, 146 F. (2d) 518;

Western Union Tel. Co. v. Bromberg, 143 F. (2d) 291.

Rule 52(a) of the Federal Rules of Civil Procedure does not operate to entrench with finality the inferences or conclusions drawn by the trial court from its findings.

> *Kuhn v. Princess Lida of Thurn & Taxis,* 119 F. (2d) 704, 705, 706;
>
> *Bach v. Friden Calculating Machine Co.,* 155 F. (2d) 361, 364.

Where, as here, the proponent has produced a mass of stipulated evidence and uncontradicted testimony sufficient to throw upon the opponent the duty of producing substantial evidence to the contrary, it is the duty of the trial judge to find for the proponent, if that duty is not sustained.

> *Wigmore on Evidence* (1940), Vol. IX, §2495, p. 306.

Rather than burden the court with a less valuable discourse on this subject, we shall, as did Dean Wigmore, refer the court to the opinion of Judge Campbell, in *Jerke v. Delmont State Bank,* 54 S. D. 446, 223 N. W. 585. We believe that upon the principles stated therein, the trial court in the instant case was obligated to find that appellant had sustained its burden of proof in this case. Pertinent portions of the opinion are as follows:

> "Plaintiff instituted this action to recover from defendant bank the sum of $14,000 and interest, alleged to be the proceeds of a real estate loan negotiated by defendant bank for plaintiff. Defendant bank admitted the negotiation of the loan and the receipt of the proceeds thereof, but by way of counterclaim maintained that it was lawfully entitled to retain out of such proceeds of loan the sum of $10,828.80, being the amount due and unpaid upon four

certain promissory notes executed by plaintiff and owned and held by the defendant bank. * * * The case was tried to a Court and jury, and at the close of all the testimony the learned trial judge directed a verdict in favor of the defendant bank sustaining their claim of right to deduct and hold from the loan proceeds a sufficient amount to pay the notes in question, and judgment was thereon entered, and appeal taken to this Court, as a result of which appeal the judgment below was reversed; the opinion of this Court being found in 216 N. W. 362, where the facts in the case are set out at some length. * * * In our former opinion we held, in substance, first, that, fraud in the inception of the notes having been admitted, the burden of proof in the strict and proper sense of the phrase (that is, the duty of establishing conviction on the ultimate issues in the mind of the trier of the facts, as contradistinguished from the duty of advancing at any given stage of the case with the production of evidence) was upon the plaintiff to establish by a fair preponderance of the evidence that it was a holder in due course; second, that the trial judge erred in directing a verdict; * * *. We will examine first the matter of our former holding with reference to the directed verdict. The former opinion held, in substance, that it was error to direct a verdict in the light of rulings of the trial Court excluding answers to certain questions, and in the light of the $5,000 certificate matter, and perhaps did not purport to pass squarely and definitely upon the matter of direction of verdict in this case, considered separately and apart from such additional matters; but the former opinion did purport to lay down a general rule or doctrine with reference to direction of verdicts in the following language:

"'* * * Where an interested witness testified that a note tainted with fraud was purchased with-

out notice and in good faith, the jury can consider all the circumstances connected with the purchase, to determine the question of good faith. And the fact that the testimony of such witness is not directly contradicted does not justify the direction of a verdict.'

"We conceive this to be a matter of no inconsiderable importance.

"1. It is the theory of our law that the entire matter of a trial between parties shall be carried on in a court of justice and under the general supervision and control of the judge thereof, and that the truth as to the facts shall be arrived at upon a consideration of the evidence and proofs presented by the respective parties in support of their respective claims. The jury, in modern law, is merely a part of the machinery of the court, and it is the part of such machinery that is made use of in proper cases for determining the truth as to the issuable facts. But we must not forget that the general superintendence and control of the Court and all its machinery, including the jury, rests with the judge, and it is fundamental that an issue arising between litigants must be tried by a general, rational, or reasoning process, both as to the ascertaining of facts and the application of the law. This has been the basic theory of the common law ever since the rule of reason replaced trial by ordeal and wager of battle. The existence or nonexistence of ultimate issuable facts must be determined from the evidence produced in court, whether the determination is made by a judge or by a jury, by a process of rationalization and judgment, and by the application of the thinking faculties of the human mind to the evidence. We are too often prone to exaggerate the powers and privileges of a jury as a trier of facts. We frequently see the phrase, 'It is for the jury to say what the

facts are.' Historically speaking, this may have been true in the sixteenth century, but it has long since ceased to be true. The power and right and duty of the jury is not 'to *say* what the facts are,' but to adjudge and determine what the facts are by the usual and ordinary intellectual processes; that is, by applying the thinking faculties of their minds to the evidence received and the presumptions existing in the case, if any, and thereby forming an opinion or judgment. The data are the evidence received in court, and nothing extraneous thereto should enter into the determination, except to the extent that the sum of the past experience of any individual always and necessarily, as a matter of psychology, enters into his formation of judgment or opinion based upon any given data. Before there is anything for submission to a jury, the evidence offered as to the ultimate facts must be such that the application of normal intellectual faculties thereto might by the customary and normal processes of reasoning arrive at different judgments or conclusions. If there is not such a state of facts a verdict should properly be directed, inasmuch as any result but one would not be a reasonable result, and the direction of a verdict in a proper case is not only the right of the judge, but it is his affirmative duty, and just as much and just as proper a part of his duty as ruling upon evidence or performing any other judicial function. * * * (At this point we state, by way of parenthesis, that in what is said herein regarding direction of verdicts we refer, of course, to civil cases. It seems to be of the spirit of our institutions that a jury in a criminal case has an inherent right to act as illogically and unreasonably and arbitrarily as to the members thereof may seem good, and this has never been more nearly brought into question than by the opinion of Mr. Justice Holmes (four justices dissenting) in

Horning v. District of Columbia (1920), 254 U. S. 135, 41 S. Ct. 53.) If reasonable minds could arrive at but one conclusion from the evidence, by applying their intellectual processes thereto, then the question as to whether the party having the burden of proof has established the issuable facts in that particular case is a question to be decided by the judge, and not by the jury. And it is probably a mere matter of phraseology and definition of terms in such a case whether we say, as a matter of language, that it then becomes a question of law for the Court, or whether we say that, being a question of fact upon which reasonable minds could not differ, it is such a question of fact as will be decided by the judge, and not by the jury, though undoubtedly the latter phrasing is more accurate.

"The only objection thereto is that it seems to conflict with the words so often used in the books since Lord Coke first quoted, *'Ad quaestionem facti non respondent judices, ad quaestionem juris non respondent juratores,'* namely, that 'questions of fact are for the jury.' Like most glittering generalities, this statement, to borrow the expression of Professor McBain, is 'weak and infirm of its own generality.' Granting that it may have been true at a time when the function of jurors was to report the facts to the Court of their own knowledge, it has not been true since the days, now more than 200 years, when it came to be the function of the jury to determine the facts by applying the reasoning processes of their minds to the evidence brought into court. Jurors do not determine all questions of ultimate fact, even in jury cases. They determine the existence or non-existence of those facts, and those only, with reference to the existence of which the judgment of reasonable men might differ as a result of the application

of their intellectual faculties to the evidence. If the proof offered by the party having the burden in support of the existence of ultimate issuable facts is so meager that a reasonable mind could not therefrom arrive at the existence of such ultimate fact, there is nothing for the jury, and the judge not only may, but should, direct a verdict against the party having the burden of proof. This is the ordinary case of directing a verdict against the party having the burden of proof, because of the insufficiency of the evidence, and with this no Courts seem to have had any difficulty. On the other hand, it is just as true that, if the party having the burden of proof offers such evidence in proof of the existence of the ultimate issuable fact that a reasonable mind functioning thereon could not escape the inference, or conclusion, or opinion, or judgment that such fact existed, then here too is left no question for the jury, and the judge should direct a verdict in favor of the party having the burden of proof. Here, also, Courts for the most part have little difficulty. The general procedure is laid down, and the language used by the courts indicated, in 26 R. C. L. 1073.

"2. A few Courts, very considerably in the minority, however, seem here to have been troubled with the matter of credibility of witnesses. The factor of credibility less frequently enters into the direction of a verdict against the party having the burden of proof, because in such cases the credibility is usually assumed, or at least not brought into question. But the entry of the factor of credibility, either one way or the other, can make no difference in the operation of the fundamental principle which necessarily underlies the direction of verdicts in all cases. The question of whether reasonable minds could arrive by reasoning processes at more than one opinion or conclu-

sion is always a question for the judge. The entry of the factor of credibility means simply the existence of one more item upon which the intellectual faculties are to operate. Of course, as the items to be reasoned upon increase in number, the likelihood of there being but one possible reasonable result mathematically diminishes; but, when that situation does exist, it should not be affected by the fact that credibility is also involved. A jury has no greater or better right to act arbitrarily or unreasonably in forming a judgment or opinion as to whether or not a witness speaks the truth than it has to act unreasonably in arriving at any other opinion or conclusion. Forming an opinion as to credibility should be just as much a process of rationalization or reasoning from the data presented in the light of human experience as the formation of any other opinion or judgment in a court, and this has always been recognized by the great majority of the courts, and the proposition, subject to various qualifications, has been laid down in some such phrasing as that 'the positive testimony of a disinterested, uncontradicted witness cannot be arbitrarily or capriciously disregarded by the jury.'

"3. Pursuing the matter somewhat further, we come to the precise question involved in the instant case, where the party having the burden of proof depends for establishing the existence of the ultimate fact, either in whole or in part, upon the oral testimony of a witness who is interested in the transaction.

"The answer to this question does not state any rule of law, but merely announces a determination of logic or reason. The only rule of law involved is that which announces that the judge will determine the matter without the assistance of the jury, when reasonable minds applied to the evidence could prop-

erly come to but one conclusion. The legal principle is simple, and the real question in every case is not a question of law in any proper sense of the word, but is a question of logic, or reason, or judgment (however we may choose to phrase it), and it is in each case a question for the judge (or for the appellate court, as the case may be), and must remain such a question, regardless of the admitted fact that there is no external standard or yardstick whereby we may determine with mathematical precision what result reasonable minds must arrive at in the field of opinion or judgment, by the application of their intellectual faculties to certain given data. The standard of reasonableness is subjective, and it is the standard of the judge that must be used; probably in the final analysis the standard of the Court of last resort in any given jurisdiction; but the nature of determination remains the same. When a Court holds in any given case or upon any given facts, that the direction of a verdict is proper, it is not in any strict sense announcing a rule or doctrine of law, but is merely announcing its judgment or opinion as a matter of reason and logic that in that case and upon those facts reasonable minds could not differ as to the result to be reached.

"4. Our question further narrows to this then: Ought a judge to say, as a matter of reason and judgment, that the mere fact that a witness is interested in the matter in controversy, in and of itself, without regard to other circumstances of the case, makes it reasonable to disbelieve or to fail to believe his testimony, in the light of general human experience? We do not believe that any Court has gone so far as to lay down any such doctrine, or enunciate any such general principle, whether it be viewed as a matter of law, or as a matter of logical rationaliza-

tion. The sound view seems to us to be this: That each case must depend upon its own facts, and that the mere fact of interest in the controversy does not, in and of itself, and apart from other circumstances appearing in the case, render it a reasonable thing to disbelieve the testimony of a witness whom otherwise it would be unreasonable to disbelieve, and this, we think, is the established practice of the great majority of courts.

"Massachusetts, which was cited in support of the doctrine enunciated in our former opinion, probably goes farther than any other Court in limiting the right of a judge to direct verdict in favor of the party having the burden of proof, where the testimony of an interested witness is involved; in other words, in holding in substance that the mere fact of interest, in and of itself, renders it reasonable to disbelieve a witness. * * * A majority of the Courts, however, have anounced other views on this question, indicating in substance the view that it is not a reasonable thing to say, in general, that a witness has perjured himself or has testified falsely, either intentionally or unintentionally, merely because of an interest in the case, where his testimony is not contradicted, is not opposed to general human experience, is not inherently improbable, and is not put in question by other circumstances appearing in the case; and the majority of the Courts have held that a judge may and should direct a verdict in a proper case for the party having the burden of proof, even though the facts were established, in whole or in part, by the testimony of the party himself or an interested witness. * * *

"5. Upon principle, therefore, and upon the authorities, and upon the previous practice of this Court, we are satisfied that we erred in the former

opinion in adopting, either expressly or by implication, the doctrine of the Massachusetts Court that testimony of an interested witness always and of necessity makes a jury question. And we are satisfied that the better view, as well as the one according with the previous practice of this Court, is that the rule of reasonable judgment must be applied to each case upon its particular facts; and, if the testimony in behalf of the party having the burden of proof is clear and full, not extraordinary or incredible in the light of general experience, and not contradicted, either directly or indirectly, by other witnesses or by circumstances disclosed, and is so plain and complete that disbelief therein could not arise by rational processes applied to the evidence, but would be whimsical or arbitrary, then, and in such case, it is not only permissible, but highly proper, to direct a verdict, and the direction of such verdict should not be prevented merely by reason of the fact that one or more of the witnesses are interested in the transaction or the result of the suit."

2. Substantiality of Evidence to Sustain Trial Court's Conclusion.

The second point in this portion of the argument referred to *ante,* at page 21, is whether there is in the record any substantial evidence to support the trial court's ultimate conclusion as distinguished from its findings of fact. Admittedly, if there were in the record evidence from which the trial court could reasonably and logically conclude that the purpose existed, its conclusion should be sustained. In such case, however, the conclusion would not be bottomed upon a failure of proof by appellant.

The findings of the trial court which are pertinent to this issue were as follows [R. 27-28]:

(a) In the two years in question appellant had taxable income of $37,337.55 and $26,408.50, respectively, before income taxes.

(b) In the two years in question appellant paid dividends of $17,500.00 and $2,500.00, respectively.

(c) In 1933 appellant's surplus was $153,927.78 and in 1940 it was $213,632.92.

(d) As a result of accumulations of appellant's earnings during the two years in question, appellant's stockholders escaped personal surtaxes of $2,402.99 and $4,199.68 in the respective years.

(e) Appellant's security investments at the end of its 1940 fiscal year were $157,093.29 at cost and had a fair market value of $114,125.00.

(f) Of the dividends paid in 1940, appellant's stockholders used $15,000.00 to buy their son a ranch.

(g) The properties of the school were in good repair in 1946.

(h) The properties of the school have not been substantially altered but have been modernized.

(i) The properties at present are being used for substantially the same purposes as during the taxable years in question, except that the boarding school activities have been eliminated.

These, then, are the findings of the trial court as to specific facts. Appellant here and now agrees that every one of them is correct. Admitting this, do they constitute, in the face of appellant's evidence, substantial evidence sufficient to support the trial court's conclusion? Let us examine the *substance* of these facts.

Facts (a), (b), (c) and (d) amount to this: Appellant had earnings and accumulated surplus during each of two taxable years. It distributed part of such earnings but not all of them in those years, and as a result its stockholders did not pay surtaxes which they would have paid had all the earnings been distributed. These facts and each of them are the *sine qua non* of any Section 102 case. They are true of many corporations against which no such charge is made. By themselves they signify no more than that a financial status or environment existed within which a purpose to avoid surtaxes could exist. Unaided by a presumption or some other more pertinent evidence, they mean nothing and have no substance.

Fact (e), appellant's security investments, standing unexplained, would justify an inference that a taxpayer had no reasonable need for them in its business. Appellee here so contended. However, the trial court thought the reserve which they represented reasonable because it did not, as requested by appellee, find appellant's accumulations unreasonable. Upon the record, then, it cannot be said that the ownership of these investments is substantial evidence of the purpose in issue.

Facts (g), (h) and (i), if they do anything at all, simply substantiate appellant's evidence to the effect that during the taxable years the Overtons contemplated the necessity of expending large sums to repair and modernize and to eliminate the boarding department. These facts, then, are substantial evidence in appellant's favor and are of no substance whatever in supporting a conclusion that the purpose in issue existed.

One can comb this record from end to end and, except for facts (a), (b), (c) and (d) above, find no evidence but that which supports the appellant's burden of proof. The testimony of Hugh Mann and C. G. Brown on the matter of salvage value of the school at its present site proved to be wasted effort on the part of both parties.

Giving the above facts all weight to which they were entitled, their substance is so meager that had the trial court found that they would support an inference of the existence of the purpose in issue, this court would have been justified in setting aside such finding as being against the clear weight of the evidence.

Aetna Life Ins. Co. v. Kepler, 116 F. (2d) 1, 5.

Conclusion.

Counsel are convinced that the decision in this case was conscientiously but erroneously reached by the trial court as a result of a misconception of the term "mere holding or investment company" as used in the law. Further, the court misconceived the burden of proof which appellant was required to maintain in order to prevail.

If the few meager facts upon which the trial court relies to support the imposition of this "highly penal"[14] tax constitute substantial evidence sufficient to uphold its conclusion, then in all truth, taxpayers should be told that they must prove the absence of the purpose to avoid surtaxes beyond a reasonable doubt, and not by a clear preponderance of the evidence.

Respectfully submitted,

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[14] *United States Business Corporation v. C. I. R.*, 19 B. T. A. 809.